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February 22, 2007

To: Supervisor Zev Yaroslavsky, Chairman
Supervisor Gloria Molina
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From: David E. Janssen
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SACRAMENTO UPDATE – LEGISLATIVE ANALYST'S REPORTS

Yesterday, the Legislative Analyst's Office (LAO) released The 2007-08 Budget: Perspectives and Issues and Analysis of the 2007-08 Budget Bill. These reports contain an overview of economic assumptions and revenue projections, a discussion of the major issues facing the Legislature, and a detailed analysis of the Governor's Proposed Budget with findings and recommendations. A copy of the LAO's Highlights of the 2007-08 Analysis is attached, and the full reports are available at www.lao.ca.gov.

The LAO estimates that the Governor's Proposed Budget, as represented in the Budget Bill, is unbalanced with expenditures exceeding revenues by \$2.6 billion in FY 2007-08. Absent legislative amendment, this would result in the State ending the budget year with an estimated deficit of \$726 million. The Proposed Budget forecasts a \$2.1 billion year-end reserve.

The Governor's Proposed Budget anticipates elimination of ongoing operating deficits through the prepayment of indebtedness, management of expenditures and enhancement of General Fund resources. The LAO, however, projects ongoing deficits of \$3.4 billion in FY 2008-09, \$2.5 billion in FY 2009-10, and \$1.4 billion in FY 2010-11. As a result, the LAO points out that additional solutions are necessary to bring the budget into balance, such as expenditure reductions, enhanced resources, or reduced supplemental repayments of existing budgetary debt.

ECONOMIC OUTLOOK

According to the LAO, both the State and national economies experienced slower growth in 2006. The LAO predicts that this will continue through the first half of 2007 before rebounding slightly. For the U.S. economy, Gross Domestic Product is expected to increase by 2.9 percent in 2008, after declining from a growth rate of 3.3 percent in 2006 to 2.4 percent in 2007. In California, wages and salaries are expected to show a similar dip in growth from 1.8 percent in 2006 to 1.2 percent in 2007, before increasing to 1.6 percent in 2008. The LAO forecast anticipates stable energy prices and a firming of the housing market by mid-year 2007.

STATE REVENUES

The LAO estimates General Fund revenues for FY 2006-07 through FY 2007-08 to be \$2.0 billion less than the Administration's projections. Approximately \$1.4 billion of the shortfall is from lower estimated tax revenues based on year-end anticipated tax receipts. The remainder of the shortfall is attributed to the reduced likelihood that the Administration will collect additional revenue from the ratification of tribal gaming compacts and the issuance of pension obligation bonds.

STATE EXPENDITURES

The LAO estimates that General Fund obligations are a cumulative \$800 million over the Governor's plan for FY 2005-06 through FY 2007-08. A number of factors contribute to this difference which include: 1) property tax revenue estimates to K-12 school districts that are \$204 million too high, which will require a dollar for dollar General Fund backfill; 2) proposed expenditures to K-12 schools that exceed the minimum funding requirements under the provisions of Proposition 98; 3) additional pension expenditures due to a delay in the issuance of pension obligation bonds; 4) a collective bargaining settlement with the correctional peace officers' union; and 5) unrealized savings from a statewide unallocated reduction included in the 2006 Budget Act.

OTHER BUDGET PRESSURES

In addition to the adjustments in revenues and expenditures, the LAO has identified outstanding issues that could have an impact on the Legislature's ability to pass a balanced budget. These include: 1) the legality of the transfer of State transportation funds to fund home to school transportation programs; 2) a possible adverse appellate court decision over the authorization of a cost of living adjustment for CalWORKs recipients in the *Guillen* litigation; 3) unfunded obligations associated with health care programs in State adult correctional

facilities; 4) another possible adverse appellate court decision related to fees for limited liability companies; and 5) additional costs associated with the funding of future employer obligations to pay retiree health care premiums. In total, these pressures could increase State obligations by over \$1.0 billion in one-time and ongoing costs.

The remainder of this memo focuses on the items of County interest included in the Governor's Budget which were identified in our January 10, 2007 Sacramento Update. The LAO's comments and recommendations are in bold.

General Government

Mandate Reform. The Administration is proposing a process under which the Department of Finance (DOF) will work with local agencies to develop a cost-efficient method of compliance with new laws and a relatively simple way to determine the amounts to be reimbursed to local governments. **The LAO indicates that the Administration's proposal is a good starting point for discussion, and it offers the Legislature a similar, but more extensive, proposal that includes three significant changes. The changes are: 1) simplification of the process for local governments to file reimbursement claims by placing greater emphasis on unit cost methodologies; 2) allowing mandate payment methodologies to be developed through negotiations between local governments and DOF; and 3) establishment of an alternate process to provide early settlement of mandate disputes and bypass the Commission on State Mandates review process.**

Mandate Funding. The Budget does not include funding to pay for non-education, non-AB 3632 mandate claims. The Administration believes that the State can realize a one-time savings in FY 2007-08 because: 1) funding in the 2006 Budget Act provides sufficient resources to pay for all mandate bills submitted in the current year and to make the FY 2007-08 backlog payment; and 2) Proposition 1A permits the State to pay mandate claims one year after local governments submit claims. The LAO recommends that the Administration either propose funding to pay local governments' mandate claims in FY 2007-08 (about \$150 million) or propose legislation to amend the Government Code to reflect its delayed payment schedule.

Elections. Proposes \$10.4 million in Federal funds to continue the implementation of the Help America Vote Act (HAVA). Of this amount, an allocation of \$6.5 million is proposed for implementation of the federally required VoteCal system, which replaces the existing voter registration database. The remainder would be allocated for HAVA activities, including \$1.1 million in new funds for counties on a competitive basis for assistance to individuals with disabilities; \$500,000 for voter education; \$462,000 to comply with changing

standards; \$180,000 for interim technology solutions; and \$1.7 million for HAVA administration. **The LAO indicates that the Legislature included \$760,000 for the Secretary of State (SOS) to perform reviews of electronic voting machines' underlying code. As of January 16, 2007, the SOS reports that no HAVA funds were spent for source code review. Therefore, the LAO recommends that the SOS provide an update during budget hearings on the \$760,000 in source code review funds.**

Property Tax Administration Grant Program (PTAP). Does not restore funding for county property tax administration. For the 10 fiscal years ending in 2004-05, the State appropriated roughly \$55 million annually to counties under PTAP. The County's annual share of that program was approximately \$13.5 million. **The LAO does not provide any comments or recommendations.**

California State Library. Proposes a shift of \$52,000 from the Public Library Foundation Program in order to fund the initial stage of the Integrated Library System Replacement Project, with status quo funding levels for the English Acquisition and Literacy Program. **The LAO does not provide any comments or recommendations.**

Food and Agriculture. Includes \$294.5 million, which reflects a decrease of \$33.2 million below the 2006 Budget Act. However, it provides \$1.5 million General Fund to leverage local and Federal funds for activities to control the spread and impact of invasive weeds and provides \$3.0 million General Fund for County Agricultural Commissioners for activities to detect and exclude new pests and diseases from California's agriculture and natural environment. **The LAO does not provide any comments or recommendations.**

Health

Health Care Workforce Development Program. Proposes the final \$5.7 million installment of State funds to the County to complete the State's training commitment for healthcare employees. This commitment was made in 2000 as part of the County's Section 1115 Medicaid waiver. **The LAO does not provide any comments or recommendations.**

Nursing Initiative. Provides \$757,000 in FY 2007-08 to restore nursing funding for expansion of entry-level master's nursing programs at the University of California. It also provides \$9.0 million in ongoing funding in FY 2007-08 and \$9.0 million in one-time current year funding to support additional nursing instructional capacity in community colleges. **The LAO recommends that the augmentation for the University of California's expansion of nursing programs be reduced by \$621,000, and that program expansion be**

considered as part of its regular enrollment growth. The LAO further recommends that the Governor's proposal to provide \$9.0 million for additional community college instruction be rejected because the need has not been justified.

Medi-Cal. Expenditures are estimated to be \$37.4 billion in FY 2007-08, which is a net increase of \$2.3 billion from the 2006 Budget Act. The increase is primarily due to caseload growth and the cost per eligible person. **Although the LAO indicates that the Governor's request may be higher than justified, it will wait for additional information in the May Revision before recommending any adjustments.** The LAO recommends that local-assistance funding be reduced by \$5.3 million in order to reflect lower county administration costs resulting from the reduced processing time associated with the self-certification program.

Medi-Cal Managed Care. Includes \$6.2 billion in FY 2007-08 for the 3.3 million enrollees. **The LAO does not provide comments or any recommendations.**

Enrolling Eligible Children in Health Coverage Programs. Proposes \$35.9 million to implement SB 437 (Chapter 328 of 2006), which is a pilot program in two counties to streamline enrollment of children who are eligible for Medi-Cal or the Healthy Families Program. **The LAO does not provide any comments or recommendations.**

Healthy Families Program. Expenditures are expected to grow from \$1.0 billion in FY 2006-07 to \$1.1 billion in FY 2007-08. The increase is due to a projected enrollment of 915,600 in FY 2007-08, up from 841,700 in FY 2006-07. **The LAO does not provide any comments or recommendations.**

Proposition 36. Reduces funding by \$60 million in FY 2007-08 for Proposition 36, the Substance Abuse and Crime Prevention Act of 2000. The Administration's proposed reduction is in response to Proposition 36 reforms which have been suspended by judicial injunction. The Budget proposes to use this funding reduction to provide an increase of \$35 million to the Substance Abuse Offender Treatment Program (OTP), which contains some of the reforms of interest to the Administration, and to provide savings of \$25 million on a one-time basis. If the court-challenged reforms to Proposition 36 are not implemented, the Administration proposes moving all remaining Proposition 36 funding to the OTP, which requires a 10 percent county match. **The LAO notes that the Governor's proposed reduction could cost the State more than it would save, and recommends that the Legislature restore the \$25 million in order to maintain funding for Proposition 36 programs at current year levels. If the legal challenges to Proposition 36 reforms have not been resolved by the May Revision, the LAO recommends that the Legislature**

consider placing them on the ballot at the next statewide election. The LAO also recommends that the Legislature seek legal advice from Legislative Counsel regarding potential funding streams for Proposition 36 programs.

Human Papillomavirus Vaccinations (HPV). Includes \$11.3 million (\$5.6 million General Fund) in FY 2007-08 to provide HPV vaccinations to approximately 52,000 Medi-Cal eligible women ages 19 through 26 to reduce the risk of cervical cancer. **The LAO does not provide any comments or recommendations.**

Newborn Hearing Screening Program. Includes \$1.5 million General Fund to expand the Newborn Hearing Screening Program to all California hospitals with licensed perinatal services. **The LAO does not provide any comments or recommendations.**

Trauma Care. The Budget does not address funding for trauma care services. **The LAO does not provide any comments or recommendations.**

Governor's Health Care Proposal. The Budget does not address the Governor's Health Care Proposal, which recommends a redirection of \$2.0 billion from counties. The impact of this funding scheme on the County is unclear as the plan does not specify the source of the \$2.0 billion redirection other than a reference to health care safety net, realignment, and other funding sources. Notwithstanding this reduction, according to the Administration, counties are expected to retain the Section 17000 obligation to provide health care to those who otherwise lack access to treatment. **In a separate report on the Governor's Health Care Plan the LAO indicated that up to \$1.4 billion in Federal funds and up to \$1.0 billion in realignment revenue from counties appear to be at risk. The LAO found that a Federal law governing employer health benefit plans could block key features of the Governor's plan. In addition, costs of the plan may be higher than projected because the uninsured population may be larger than forecast, the growth in medical care costs outpaces the growth in wages and payrolls, and the cost to provide coverage through the State's purchasing pool may be higher than anticipated. The LAO further questions the assumption that all anticipated Federal matching funds will be made available. On a positive note, the LAO also estimated that up to \$600 million in additional State resources may be available from additional premium payments and the elimination of redundant programs to offset State costs associated with implementing the health care reform plan.**

The LAO further indicates that the Governor's plan would expand programs to provide care for undocumented immigrants, estimating that between

300,000 and 600,000 children may be newly eligible for full-scope benefits through Medi-Cal or the Healthy Families Program. Undocumented adults would not be eligible for additional benefits through Medi-Cal or Healthy Families, but could obtain non-subsidized coverage through the purchasing pool. Providing care for uninsured undocumented immigrants would remain a county responsibility. The LAO does not provide any recommendations.

Public Health

Licensing and Certification. Includes \$84.2 million, a \$19.3 million increase over the Budget Act of 2006, to ensure high quality medical care in community settings and facilities by enforcing State licensing and Federal certification requirements. **The LAO recommends a reduction of \$291,000 in special funds for additional staff. The LAO also recommends that a number of Health Facilities Evaluator Nurse positions be reclassified to Health Facility Evaluator I positions, which can be filled by licensed vocational nurses instead of registered nurses, which will help to reduce the number of vacant positions.**

HIV/AIDS Treatment and Prevention. Includes \$299.4 million for the AIDS Drug Assistance Program which provides life-saving medications to low-income persons living with HIV/AIDS. **The LAO does not provide any comments or recommendations.**

Foodborne Illnesses. Provides \$2.1 million General Fund to enhance the State's response capabilities to foodborne illnesses. **The LAO recommends that \$1.3 million be approved for additional staff and research, and that the remaining \$800,000 be rejected because the workload does not justify some of the requested positions.**

HIV Name-based Reporting. Includes \$2.0 million General Fund to provide additional local assistance funding to increase surveillance staff for HIV reporting activities, as required by County-sponsored SB 699 (Chapter 20 of 2006). **The LAO does not provide any comments or recommendations.**

Hospital Infectious Disease Control Program. Provides \$1.6 million General Fund, and \$0.4 million from the Licensing and Certification Program Fund, to implement this program, as required by County-supported SB 739 (Chapter 526 of 2006). **The LAO recommends that health care associated infection surveillance and prevention program be largely funded by the Licensing and Certification fund instead of General Fund because health care facilities directly benefit from the program and it should be fee supported.**

Mental Health

Proposition 63. Projects an increase over previous estimates by \$312.1 million in FY 2006-07 and \$495.7 million in FY 2007-08, for a total estimate of \$1.6 billion in FY 2006-07, and \$1.8 billion in FY 2007-08. These funds are continuously appropriated to the State Department of Mental Health for county implementation. According to the Department of Mental Health, approximately \$51 million in FY 2006-07 and \$81 million in FY 2007-08 may be available for Los Angeles County. **The LAO does not provide any comments or recommendations.**

Early and Periodic Screening, Diagnosis and Treatment Program (EPSDT). Includes an increase of \$92.7 million General Fund and \$95.1 million Federal reimbursement authority above the Budget Act of 2006. The increase is attributable to additional costs and the volume of unpaid county claims. **The LAO withholds recommendation on funding for EPSDT until receipt of the California Department of Mental Health's revised EPSDT estimating methodology. The LAO recommends that the Legislature require the Office of State Audits and Evaluations to report at budget hearings on their review of the Department's EPSDT estimating methodology and related administrative practices.**

Integrated Services for Homeless Adults with Serious Mental Illness. Proposes the elimination of this \$54.9 million program, which provides funding to local mental health agencies to act as the single point of responsibility for comprehensive services for individuals who are homeless or at risk of homelessness or incarceration and have a serious mental illness. The Budget proposal indicates that similar services are available to individuals under Proposition 63, which the County strongly opposes because language in the initiative contains an anti-supplantation clause, and the expenditure of funds allocated to counties is decided through the local community stakeholders' process. **The LAO does not provide any comments or recommendations.**

AB 3632 Program. Proposes \$52 million to reimburse counties for mandated AB 3632 mental health services. The 2006 Budget Act provided about one-half of the estimated costs for the AB 3632 Program in the current year, and these additional funds will fully fund the anticipated costs in FY 2006-07. **The LAO points out that, based on county data, the cost of providing services under the AB 3632 mandate will exceed the budgeted amount. The LAO estimates that counties will request \$40 million in the current year and about \$90 million in the budget year through the mandate reimbursement process.**

Social Services

CalWORKs Services. Proposes \$463.4 million for CalWORKs administration, an increase of \$8.3 million above the FY 2006-07 appropriation. **The LAO does not provide any comments or recommendations.**

CalWORKs Improvement. Maintains \$90 million to counties to enhance efforts to increase work participation rates. **The LAO does not provide any comments or recommendations.**

CalWORKs Reforms. Proposes reforms to the CalWORKs program for an estimated savings of \$324.4 million, which includes:

- Full family sanctions for CalWORKs families when the adult does not comply with work requirements beyond 90 days.
- Elimination of CalWORKs payments after the 60-month time limit for children when the able-bodied adult fails to meet the Federal work participation requirements.
- Limiting of child-only benefits to 60 months when the parent or caretaker is an undocumented non-citizen, a convicted drug felon or a fleeing felon.

The LAO recommends that the Legislature reject the Governor's proposals to limit CalWORKs cash benefits for children. As an alternative to the full family sanction, the LAO recommends enactment of legislation to: 1) require a home visit or other in-person contact with each family who is out of compliance for three months or more, and 2) increase the sanction to 50 percent of a family's grant if the adult refuses to comply with participation requirements.

CalWORKs and Food Stamp Reporting. Proposes changes to the CalWORKs and Food Stamp reporting requirement from quarterly to semi-annual effective January 1, 2009. **The LAO does not provide any comments or recommendations.**

CalWORKs Pay for Performance Allocation. Includes \$40 million for incentive payments to counties which would be allocated based on measured outcomes in work participation and employment rates achieved in FY 2006-07. **The LAO does not provide any comments or recommendations.**

CalWORKs Child Care. Proposes \$530.8 million for Stage 1 Child Care and \$471.2 million for Stage 2 with 5.0 percent of this total (\$50.1 million) held in reserve. **The LAO does not provide any comments or recommendations.**

Child Care and Development Quality. The LAO recommends that the Legislature convene a workgroup to create a child care and development plan to define, measure, publicize, and reward program quality. The LAO suggests that the plan include the following elements:

- Define factors of quality to be assessed and define tiered levels of quality for each factor.
- Develop a standardized method to measure and rate quality.
- Create incentives for child care and development providers to improve quality.
- Identify use of State funds to support program quality.

CalWORKs Cost of Living Adjustment (COLA). Withholds the 4.21 percent July 2007 COLA for a savings of \$140.3 million. The LAO recommends redirecting \$124.4 million of the funds for the January 2008 SSI/SSP COLA to provide a CalWORKs COLA.

Statewide Fingerprint Imaging System (SFIS). Proposes \$7.97 million to maintain SFIS. The LAO does not provide any comments or recommendations.

Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) System. Proposes \$12.6 million to reflect increased contract costs and \$2.0 million for the LEADER replacement system in the social services budget. The LAO recommends that the California Department of Social Services and the Office of System Integration report to the budget committees on the reasons that LEADER cannot join one of the existing automation consortia and recommends that funds for additional LEADER planning activities be withheld until a cost benefit analysis is provided to the Legislature.

In-Home Supportive Services (IHSS). Proposes General Fund spending of \$1.5 billion in FY 2007-08, an increase of 5.4 percent over FY 2006-07 due to increased caseloads. The State proposes to freeze its participation in IHSS wages and benefits at \$11.10 per hour. The LAO recommends that funding for IHSS be reduced by \$26.9 million in FY 2006-07 and \$33.9 million in FY 2007-08 because the caseload is overstated. The LAO provides the Legislature with three alternative recommendations to the Governor's proposal to freeze IHSS wages:

- Reject the Governor's proposal and allow the final wage trigger to increase State participation in IHSS wages and benefits to \$12.10 per hour;

- **Eliminate the final wage trigger, but allow State participation up to the current limit of \$11.10 per hour; or**
- **Delay the final wage increase indefinitely.**

Supplemental Security Income/State Supplementary Payment (SSI/SSP) COLA. Proposes \$216.7 million General Fund to provide the January 2008 COLA. The LAO estimates the cost of SSI/SSP COLA to be \$171.6 million and recommends providing a partial COLA to SSI/SSP using \$47.2 million with the remainder funding the CalWORKs COLA as reported above.

Child Welfare. Increases funding for Child Welfare Services by \$94.4 million for a total allocation of \$4.0 billion. The LAO notes that funding for counties operating under the Title IV-E waiver is capped and recommends that the Legislature establish an emergency reserve fund which could be offered to waiver counties and triggered by an increase in the child welfare caseload.

Child Welfare Enhancements. Maintains \$255 million allocated in FY 2006-07 to improve outcomes for children in foster care and proposes an additional \$5.4 million for children placed in out-of-home care by county probation departments and to identify mental health and developmental needs of children in foster care, and to monitor program performance. The LAO notes that California is at risk of incurring Federal sanctions and fiscal penalties for failure to meet child welfare performance outcomes, and recommends that the Legislature continue to closely monitor the State's performance.

Child Support Services. Proposes \$194.9 million General Fund for local agency administrative costs, approximately the same level of funding provided in FY 2006-07. The LAO does not provide any comments or recommendations.

Back-fill of Federal Incentive Payments. Proposes \$23 million General Fund to maintain funding for local child support agencies due to provisions in the Federal Deficit Reduction Act which prohibit the State from claiming Federal matching funds using earned Federal incentive payments. The LAO does not provide any comments or recommendations.

Justice and Public Safety

Prison and Jail Overcrowding. The Governor's Strategic Growth Plan (SGP) provides \$9.6 billion in bond funding to address overcrowding in State prisons and county jails; \$4.4 billion of that amount is intended to fund the construction of county jail facilities, and will require a 25 percent local match. Availability of these funds is subject to voter approval. The LAO notes that the Administration's \$9.6 billion prison overcrowding package has merit

because it provides a balance between adding new beds and reducing the inmate population. However, the LAO estimates that it would result in a large surplus of State prison capacity, provide the wrong mix of beds, increase local jail overcrowding, and generate costs that have not been fully identified. The LAO recommends consideration of an alternative package that would address overcrowding, result in a smaller surplus of prison capacity, and reduce State costs relative to the Governor's proposal.

In addition, while the LAO finds that some State assistance to counties to build new jail facilities is reasonable because some adult offenders would be shifted from the State to counties, the LAO recommends that the Legislature conduct hearings to resolve key policy, operational and fiscal issues pertaining to the proposal. For example, the Legislature should request information from stakeholders regarding the appropriate level of local match, the number of beds needed to relieve local jail overcrowding, actual costs to construct jail facilities, the capacity and interest of counties to operate additional jail space, and the coordination of this proposal with the proposed shift of inmates.

Incarceration of Non-Violent Felons. Beginning July 1, 2008, non-serious, non-violent felons with terms of three years or less will serve their sentences in county jails. The Proposed Budget does not provide operational funding for this population. The State has indicated that it will work with local governments to address these costs. **The LAO recommends that the Legislature instead change the definition of some of the proposed crimes from felonies to misdemeanors so that offenders would serve a maximum of one year in county jail, which would reduce the potential fiscal and operational impacts on county jail systems. The LAO notes that, in many cases, the actual time served under the proposed changes would only be a few months below the average terms actually served under current law.**

Courts. The SGP proposes \$2.0 billion in general obligation bonds to renovate or replace outdated, unsafe, court buildings to increase public safety. Availability of these funds is subject to voter approval. **The LAO withholds recommendation on the bond issue pending further review of the proposal, and rejects the companion legislation for public-private partnerships to construct courthouses because it provides a weak model for legislative control and oversight of these major projects. If the Legislature approves the bond issue, the LAO recommends that implementing legislation limit the availability of this funding to improving or replacing courthouses that have been transferred to the State. The LAO also believes that allowing bond funds to be used when courthouses have not been transferred could**

provide a disincentive for counties to follow through with the transfer process.

Mentally Ill Offender Crime Reduction Grants (MIOCR). Provides \$45 million in FY 2007-08 for MIOCR Grants, with half for juveniles and half for adult inmates. **The LAO does not provide any comments or recommendations.**

New Judgeships. Includes an augmentation of \$27.8 million General Fund in FY 2007-08 and \$74.3 million General Fund in FY 2008-09 to add 100 new judgeships over a two-year period beginning in April 2008. The expenditure of these funds is restricted until legislation authorizing new judgeships is enacted. **The LAO does not provide any comments or recommendations.**

Safe at Home Program. Provides \$292,000 to expand the Safe at Home Program which provides services to victims of domestic violence and stalking, and is now expanded to include victims of sexual assault. **The LAO does not provide any comments or recommendations.**

Proposition 83 (Jessica's Law). Provides \$30.4 million in FY 2006-07 and \$77.3 million in FY 2007-08 to implement Proposition 83, known as Jessica's Law, and other recently enacted measures related to managing sex offenders, including funding for GPS monitoring. **The LAO recommends that the Legislature recognize current-year savings of \$6.0 million General Fund due to a lower-than-projected sexually violent predator caseload, and also recommends that the Legislature wait until more information is available before funding additional administrative and caseload costs. The LAO will provide an updated recommendation at the time of the May Revision.**

Adult Probation Funding. Includes \$50 million in FY 2007-08 and \$100 million in FY 2008-09 for local adult probation funding targeting the at-risk 18 to 25 year-old probation population, which accounts for the largest percentage of new felon admissions to the State prison system. The program will be modeled after the Juvenile Justice Crime Prevention Act program. We anticipate that most of the funding for this program will be allocated on a population basis. **The LAO recommends that this new program be scaled back to a \$5.0 million pilot project and that \$25 million of the remaining funding be shifted to expand Proposition 36 programs to current year funding. The LAO indicates that this would be more likely to achieve the intended goal of reducing inmate and jail populations.**

Shift Juvenile Justice Population to Counties. Starting July 1, 2007, the Division of Juvenile Justice will begin shifting non-violent juvenile offenders from State to local facilities, and in FY 2007-08 will provide \$53 million in block grant funding to counties to support the program and housing needs of this population.

We estimate the average block grant to be approximately \$40,000 per offender. The State will also stop accepting female juvenile offenders. This will result in a savings to the State General Fund of \$32.9 million in FY 2007-08. An additional reduction of \$10 million will result from the elimination of funding for the Juvenile Justice Community Reentry Challenge Grant. **The LAO recommends the proposed shift of State juvenile offenders to local facilities along with block grant funding to offset the related additional costs for counties, but recommends technical adjustments to reflect the full State savings that would result.**

Juvenile Camp Funding. Provides \$246 million in FY 2007-08 for juvenile camps. **The LAO does not provide any comments or recommendations.**

Juvenile Justice Crime Prevention Act and Citizens' Option for Public Safety. Provides full funding in FY 2007-08 at \$238 million. **The LAO does not provide any comments or recommendations.**

Local Juvenile Detention Facilities. Provides \$400 million in FY 2007-08 for construction of local juvenile detention facilities with a required 25 percent local match. **The LAO recommends that the Legislature reject the Governor's proposal because the Administration has failed to provide justification for new State funding given the current surplus of 4,000 such beds statewide.**

Transportation

Proposition 42. Proposes to fully fund Proposition 42 valued at \$1.475 billion for FY 2007-08, of which \$699 million is allocated to the State Transportation Improvement Programs (STIP), and approximately \$117 million will be allocated to projects in the Los Angeles region.

Pursuant to current law, cities and counties are not scheduled to receive any local streets and roads maintenance funds from Proposition 42 in both FY 2006-07 and FY 2007-08, in lieu of the cities and counties receiving monies from the State Highway Account in FY 2001-02 and FY 2002-03 for local streets and roads maintenance.

The Budget also proposes the repayment of \$83 million in Proposition 42 monies, which is the minimum amount required under Proposition 1A. This amount will be distributed in the same manner as Proposition 42 monies, which does not include any funds to local agencies. The State still owes the County approximately \$2.0 million for repayment of previously borrowed Proposition 42 funds. **The LAO does not provide any comments or recommendations.**

Transportation Bond - Proposition 1B. Proposes to allocate \$523 million in FY 2006-07 for high priority projects that are ready to start construction under various programs of Proposition 1B. Of this amount, \$262 million and \$5.0 million will be allocated for projects under the STIP and the Local Bridge Seismic Retrofit Program, respectively. Local jurisdictions, including Los Angeles County, are recipients of these funds through competitive grants. The FY 2006-07 proposals will be introduced by the Legislature in separate legislation.

In addition, the Budget proposes to allocate \$2.8 billion for Proposition 1B programs in FY 2007-08. Of this amount, \$600 million is for the Local Streets and Roads Program under which the County would receive a direct allocation of \$58.2 million, and \$891 million will be allocated for other programs where local jurisdictions, including Los Angeles County, are eligible to receive these funds through competitive grants. However, these initial allocations may be adjusted as expenditure guidelines under Proposition 1B are developed and projects are approved for funding.

The LAO recommends statutory and administrative measures to ensure effective implementation of the bond program, including providing bond funding annually to enhance legislative oversight and recommending that the Administration provide the Legislature a list of potential projects that would be ready for bond funds to substantiate the requested amount by May 1, 2007. The LAO also recommends the enactment of legislation to require administrative expenditures be reported separately in the California Transportation Commission's annual reporting on Proposition 1B bond programs. Furthermore, the LAO recommends deletion of budget bill language that allows the Administration to transfer appropriated bond funds between Proposition 1B programs because it would circumvent accountability in the use of funds, and runs counter to the measure's intent to allocate specific amounts for particular purposes.

Tribal Gaming Proceeds. There is still \$1.0 billion in outstanding transportation loans, including Proposition 42 monies due from the suspension back in FY 2003-04, which remains dependent upon the sale of tribal gaming bonds.

Several lawsuits have prevented the bonds from being sold, and the projected date that the tribal bond revenues will be available has changed numerous times. The proposed Budget now assumes spending the tribal compact cash as it is received until the date that the sale of bonds can be determined. The budget proposes to deposit \$100 million from each of FY 2006-07 and FY 2007-08 into the State Highway Account. Local jurisdictions, including Los Angeles County, are recipients of part of these funds through competitive grants.

The Budget also includes \$506 million in General Fund revenue from the approval of additional tribal gaming compacts. **The LAO indicates that if tribal bonds are not issued, repayments to transportation loans would take until FY 2016-17 to repay with tribal compact revenues as they become available.**

Public Transportation Account (PTA). \$1.11 billion in transportation funds is to be transferred to finance costs that are normally paid by the General Fund. Of this amount, \$617 million would have been allocated to the STIP. The Los Angeles region would have received over \$54 million of these STIP funds. **The LAO recommends that the Legislature establish priorities for PTA expenditures in FY 2007-08 to clarify which expenditures would not be made if PTA funds are insufficient and recommends the Administration advise the Legislature at budget hearings on transit capital projects that would be delayed or not funded as a result of the budget proposals. Furthermore, the LAO recommends enactment of legislation to eliminate "spillover" revenue into the PTA beginning in FY 2008-09 in order to simplify the State's transportation funding structure.**

Rail Operations. Proposes \$123 million to manage and coordinate intercity rail passenger services that provide commuters with a range of transportation options, help to improve the State's air quality, and reduce highway congestion and fuel consumption. **The LAO does not provide any comments or recommendations.**

Housing

Housing Bond - Proposition 1C. Proposes \$373 million in awards to the following program areas authorized by Proposition 1C: \$88 million for affordable homeownership programs; \$140 million to provide affordable rental housing; \$40 million for farm worker housing; \$95 million for homeless permanent housing construction; and \$10 million for homeless shelter housing construction. Proposition 1C authorizes the State Department of Housing and Community Development to make these expenditures without additional legislative authorization.

In addition, the Budget proposes \$40 million for the Building Equity and Growth in Neighborhoods (BEGIN) Program, which provides grants to cities and counties to make deferred-payment second mortgage loans to qualified buyers of new homes, and \$95 million for the Transit-Oriented Development Program to develop and construct housing projects close to transit stations. Funding for both of these programs is required to be annually appropriated by the Legislature.

Furthermore, the Budget includes \$145 million in awards for three programs that Proposition 1C requires be further specified through the adoption of additional legislation: \$100 million for Infill Incentive Grants; \$15 million for affordable housing innovation programs that demonstrate cost-saving ways to create or preserve affordable housing; and \$30 million for the Housing and Urban-Suburban and Rural Parks Program to create incentives to increase housing production by rewarding local governments with grant funds to create or improve well designed parks. The Administration will propose budget trailer bills to implement these programs to provide incentives for the creation of more housing.

The LAO recommends that the new Housing Urban, Suburban and Rural Parks program established by Proposition 1C be administered by the Department of Parks and Recreation (DPR) instead of the Department of Housing and Community Development (HCD) because DPR has administered various park grant programs for many years while HCD has only limited experience in park development and funding. The LAO also recommends appropriating \$30 million in Proposition 1C park funds to DPR instead of HCD for allocation to local projects. Furthermore, the LAO recommends enactment of legislation to specify what portion of the \$850 million for a new Regional Planning, Housing and Infill Incentive Program should be allocated to parks and recommends that DPR be designated as the agency to administer the portion of park funding out of the \$850 million infill incentive program.

Supportive Services. Proposes to direct \$30 million of combined Proposition 46 (Housing and Emergency Shelter Trust Fund Act) and Proposition 63 funds to provide homes with supportive services for seriously mentally ill homeless individuals and their families. **The LAO does not provide any comments or recommendations.**

Natural Resources and Environmental Protection

AB 32 – Global Warming Solutions Act. Proposes \$35.8 million from various funds to implement the Act, which requires greenhouse gas emissions to be reduced to 1990 levels by 2020 and authorizes the development of a market-based compliance program.

Specific activities include: \$3.5 million to the Air Resources Board (ARB) for collecting greenhouse gas emissions data in California; \$1.8 million to develop the Emission Reduction Scoping Plan; \$12 million to develop market-based mechanisms; \$7.1 million to identify and develop emission reduction measures; \$7.4 million for scientific and economic analysis to ensure that emission reductions are achieved in a cost-effective manner; and \$4.0 million for program oversight and coordination.

The LAO indicates that the Legislature placed the ARB in charge of implementation of the act while recognizing that the Secretary for Environmental Protection would have a coordination role in terms of the State's overall climate change policy. The LAO finds that the budget proposal expands the Secretary's role beyond coordination to include activities such as planning, monitoring, technical analysis, and oversight, many of which are programmatic activities. Therefore, the LAO recommends denying the \$1.4 million budget request to expand the Secretary's role.

In addition, the LAO recommends that the 24 positions requested for ARB related to market-based mechanisms be for a three year limited term and recommends the adoption of budget bill language prohibiting funding for implementation of market mechanisms until the board has evaluated them and submitted a report for legislative review. Furthermore, the LAO recommends denial of \$1.3 million to the California Public Utilities Commission to conduct climate change-related proceedings and research before the ARB discharges its statutory requirement on the subject.

Finally, the LAO recommends that the Administration report at budget hearings on its long-term funding plans for the State's greenhouse gas emissions reduction activities and recommends adoption of supplemental report language requiring a long-term funding plan to be submitted in conjunction with the FY 2008-09 Governor's Budget.

Low-Emission School Buses. Proposes \$96.5 million from Proposition 1B to replace 535 school buses that are more than 20 years old, and retrofit approximately 1,500 old diesel school buses. **The LAO does not provide any comments or recommendations.**

Hydrogen Highways. Proposes \$6.0 million to the Air Resources Board to continue development of the Hydrogen Highway, which is part of the Governor's Hydrogen Highway Blueprint Plan that includes a goal of establishing 50 to 100 hydrogen fueling stations in California. These dollars will provide matching funds for up to eight publicly accessible hydrogen fueling stations and will prioritize funding for stations that generate hydrogen from promising renewable technologies, such as biomass, solar, and wind energy. **The LAO does not provide any comments or recommendations.**

Water Quality – Proposition 84. Proposes a total of \$1.1 billion for Proposition 84, including \$111.4 million for the State Water Resources Control Board for water quality programs, \$75.7 million to provide low interest loans or grants for wastewater treatment facilities and pollution control projects; \$6.2 million for the Agricultural Water Quality Grant Program; \$14.6 million for the

Urban Storm Water Grant Program; \$8.8 million for the Clean Beaches Grant Programs; and \$6.1 million for basin and land use planning activities.

The LAO indicates that the Legislature should consider a number of issues when evaluating the Governor's Budget proposals to ensure the effective and efficient implementation of Proposition 84. This includes: 1) retaining legislative oversight of bond expenditures; 2) defining funding eligibility; 3) ensuring that administrative costs are reasonable; 4) addressing issues of State-local cost sharing and Federal funding; and 5) coordinating similar programs across bonds. In addition, the LAO recommends deletion of Proposition 84 funds proposed for biomass utilization projects, as support for such energy-generating facilities should be evaluated by the California Energy Commission, and recommends deletion of bond funding for regulatory activities.

Brownfields. Proposes \$3.1 million to accelerate the cleanup of approximately 750 additional brownfield sites. **The LAO does not provide any comments or recommendations.**

Ocean Protection. Proposes to allocate \$28 million from Proposition 84 in FY 2007-08 to create marine protected areas, ensure sustainable fisheries, and regulate marine industries. **The LAO does not provide any comments or recommendations.**

Bioenergy. Proposes \$5.1 million, principally from Proposition 84, to advance the Governor's bioenergy initiative, which is designed to increase the use and availability of renewable energy, reduce reliance on fossil fuels, mitigate the risk of catastrophic wildfire, and address some of the State's critical waste disposal and environmental problems. **The LAO recommends that the Legislature hold joint policy and budget hearings to review the State's progress in meeting the Renewables Portfolio Standard, and to consider the Energy Commission's proposals to improve the effectiveness of its renewable energy program, some of which may require statutory changes.**

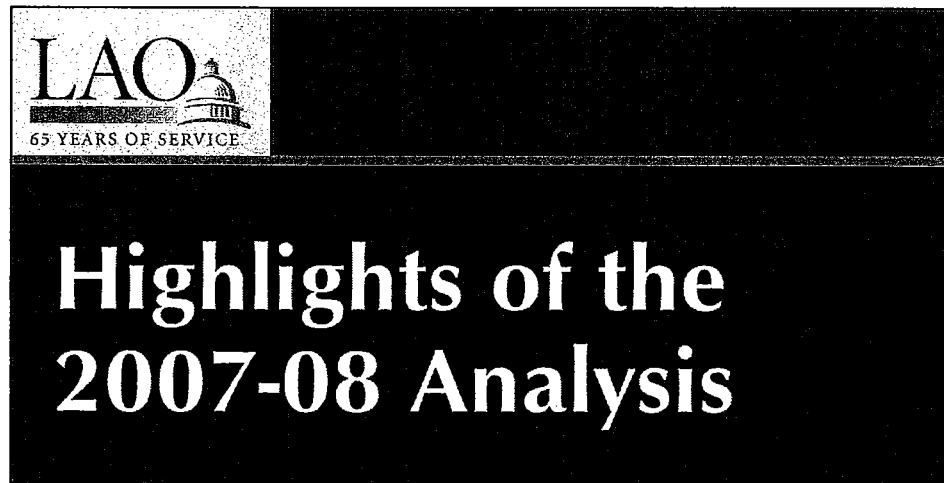
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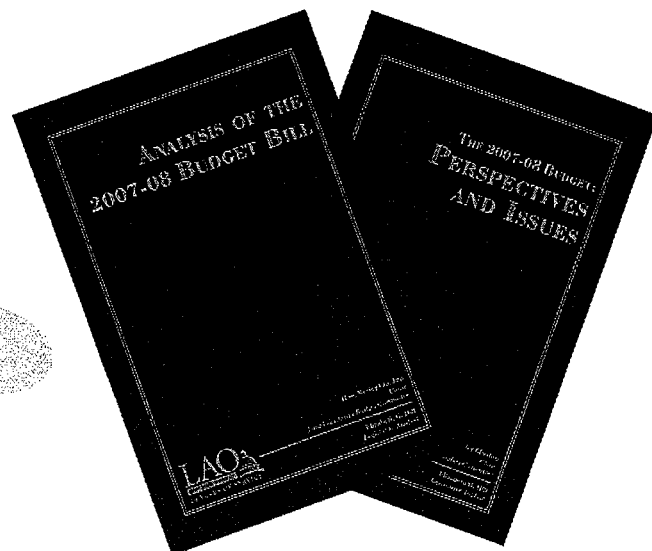
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c: All Department Heads

February 21, 2007



ELIZABETH G. HILL • LEGISLATIVE ANALYST



AN LAO REPORT

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Acknowledgments

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PERSPECTIVES AND ISSUES

PART I—STATE FISCAL PICTURE

- The Governor's budget attempts to bridge a significant fiscal shortfall in 2007-08 through a variety of means, including a major redirection of transportation funds, significant reductions in social services, and a substantial increase in tribal gambling revenues.
- Based on our projections, we estimate that the Governor's budget plan would result in 2007-08 expenditures exceeding revenues by \$2.6 billion. This would leave the state with a \$726 million year-end deficit, compared to the Governor's January 10th estimate of a \$2.1 billion positive reserve.
- In addition, the state would face operating deficits of \$3.4 billion in 2008-09, \$2.5 billion in 2009-10, and \$1.4 billion in 2010-11.
- Thus, additional solutions will be needed to bring the budget into balance, such as budgetary savings, enhanced resources, or reduced supplemental payments toward paying off budgetary debt. It will also be important to avoid raising ongoing budget commitments without identifying alternative reductions or new revenues to pay for them.

PART II—PERSPECTIVES ON THE ECONOMY AND DEMOGRAPHICS

- Both the U.S. and California experienced continued economic expansion with modest inflation in 2006. The pace of growth varied during the year, however, being strong early-on, slowing subsequently due to a sharp decline in housing, and strengthening some at year-end.
- We forecast that California's economy will continue to expand in 2007, but at a slower pace than 2006. Growth will be weakest during the first half of the year but accelerate as the year progresses and the housing market stabilizes.
- This forecast is subject to risks, however, primarily relating to the future course of energy prices and whether the housing market stabilizes without adversely affecting the economy generally.

PART III—PERSPECTIVES ON STATE REVENUES

- Following two years of significant growth, revenues in 2006-07 appear to have slowed sharply, reflecting the more moderate economic expansion and a dip in income from capital gains.

- The budget assumes that revenue growth will revive somewhat in 2007-08.
- Budget-year revenues include nearly \$800 million from policy-related changes, including over \$500 million in additional tribal gambling revenues and about \$300 million from tax-related actions.
- We forecast that revenues and transfers will fall below the budget forecast for the current and budget years combined by about \$2 billion, primarily reflecting our weaker personal income tax projections.

PART IV—PERSPECTIVES ON STATE EXPENDITURES

- The budget proposes total state expenditures of \$130.8 billion in 2007-08, including \$103.1 billion from the state's General Fund and \$27.7 billion from special funds.
- General Fund spending would grow by a small 1 percent between 2006-07 and 2007-08, while special funds spending would grow by 13 percent. The year-to-year changes in many programs are affected by special factors, such as transfers of programs, funding redirections, and one-time actions.
- Spending for Proposition 98, the General Fund's largest program area, is proposed to be \$36.9 billion, an increase of only 0.5 percent. This relatively low growth rate reflects the Governor's proposal to shift home-to-school transportation expenditures from Proposition 98 to the Public Transportation Account, as well as the administration's assumption that local property tax revenues (which reduce General Fund expenditures for schools) will increase fairly rapidly, despite the state's real estate slowdown.
- Despite some repayment progress in recent years, the state would still have \$18 billion in budgetary debt outstanding at the close of the budget year. General Fund costs related to this debt would be \$4.1 billion in 2007-08 and peak at \$4.5 billion the following year.
- On a real per capita basis, total spending proposed in the budget would decline slightly in 2007-08. As a percent of state personal income, total spending would also decline slightly in 2007-08, to 8.5 percent.

PART V—MAJOR ISSUES FACING THE LEGISLATURE

Governor's Tax Proposals Make Sense

- The Governor is proposing to permanently eliminate the existing teacher retention tax credit, which was adopted in 2000 but was suspended in four of the past six years. We analyze the credit and conclude that it is neither an effective nor cost-efficient means of either retaining teachers or reimbursing

them for the supplemental instructional materials and supplies they choose to purchase. We thus recommend that the credit be eliminated. Doing so would generate revenues of \$165 million in 2007-08 and increasing amounts annually thereafter.

- The Governor also is proposing to make permanent the current temporary one-year test for determining whether a vessel, vehicle, or aircraft purchased out-of-state should be subject to California's use tax. We discuss the findings of a report we prepared for the Legislature on the fiscal and economic effects of using this one-year criterion. In that report we recommended that the one-year test be made permanent, and thus we recommend that the Governor's proposal be adopted. Doing so would generate revenues of \$35 million in 2007-08 and increasing amounts annually thereafter.

K-12

➤ **Fiscal Outlook Has Implications for the Guarantee**

- Although General Fund revenues would drop in both the current and budget years under our forecast, the Proposition 98 minimum guarantee for 2007-08 would increase. When combined with an overestimate of property taxes and a risky administration rebenching proposal, the Legislature is likely to face more than \$1 billion in additional Proposition 98 General Fund obligations.
- Lower current-year revenues also mean the state's 2006-07 minimum guarantee is now roughly \$600 million lower than proposed spending. We recommend the Legislature reduce current-year spending by a like amount in areas that would have minimal impact on program. This would generate major one-time and ongoing savings while still providing enough funding to support a K-14 baseline budget in 2007-08. (*Analysis*, page E-25.)

➤ **Five-Year Forecast Shows Large Increases on the Horizon**

- Our five-year forecast projects Proposition 98 funding would increase significantly more than needed to cover current program costs (adjusted for inflation and attendance growth). Thus, we think this is an opportune time to develop a long-term roadmap for K-14 education. Such a roadmap could help the Legislature establish long-term funding priorities, coordinate investments, and maximize potential benefits by linking new monies with policy improvements. (*Analysis*, page E-33.)
- In our suggested roadmap, we highlight the achievement gap that continues persists between K-12 special education, low-income, and English learner students and other K-12 students. To address these gaps, we suggest the Legislature make various investments in child development programs and

programs for at-risk students as well as strengthen accompanying assessment and accountability systems. (*Analysis*, page E-39.)

- Our roadmap also highlights the low graduation and transfer rates of community college students. To address these issues, we suggest the Legislature provide “student success” block grants that would create incentives for improvement while still allowing community colleges flexibility to develop local solutions. (*Analysis*, page E-39.)
- Finally, our roadmap would set aside a significant portion of the new discretionary funds for fiscal solvency block grants to K-14 school districts. These would help districts address their retiree health benefit unfunded liabilities. (*Analysis*, page E-42 and E-50.)

➤ **Settlement Programs Could Be Improved**

- In response to a recent settlement, the state agreed to pay an additional \$2.5 billion over a seven-year period for a new K-12 education reform program. We have concerns with the program as established and recommend small changes that could yield big payoffs. (*Analysis*, page E-109.)
- The settlement agreement also includes funds for career technical education (CTE) at the community colleges. When combined with current support for CTE, the state will have about \$400 million over the next seven years available for this program. We recommend an approach that would support comprehensive improvement in the delivery of career technical services throughout the state. (*Analysis*, page E-53.)

HIGHER EDUCATION

➤ **Recommend Smaller Student Fee Increases for Public Universities**

- The Governor’s budget calls for a 7 percent increase in student fees at the University of California (UC) and a 10 percent increase at the California State University (CSU). Given the state has no explicit policy for setting student fees, we recommend that fees be adjusted so that students next year pay the same share of their total education costs as they are paying this year. Since we estimate that education costs will increase by 2.4 percent next year, we recommend that fees be increased by the same percentage. As a result, full-time undergraduates at UC and CSU would pay \$283 and \$192 less, respectively, than they would under the Governor’s proposal. (*Analysis*, page E-192.)

➤ **Community Colleges Have Unused Enrollment Funding**

- Enrollment at the California Community Colleges (CCC) has been declining over the past several years. At the same time, CCC’s budget has been

increased annually to accommodate enrollment growth. For the current fiscal year, we estimate that CCC will be unable to use more than \$100 million in enrollment funding. We recommend that the Legislature reduce this funding in CCC's budget in order to improve the state's overall fiscal health. (*Analysis*, page E-269.)

➤ **Reported Faculty Salary "Gaps" Are Misleading**

- The Governor's budget would direct the California Postsecondary Education Commission (CPEC) to develop a new methodology for comparing compensation for faculty at UC and CSU with other universities. The current methodology measures only salaries, and compares UC and CSU to a selected group of public and private universities.
- We agree that CPEC's measurement of faculty compensation needs to be improved. For example, while the average salary of UC and CSU faculty is lower than the average of selected comparison institutions, UC and CSU's faculty benefits (such as retirement and healthcare) tend to be well above average. As a result, CPEC's reporting of salary gaps between California's public universities and other institutions can be misleading. We recommend that the Legislature rethink the basis for comparing faculty compensation and direct CPEC to take an alternative approach on collecting and reporting specified faculty compensation information. (*Analysis*, page E-215.)

➤ **Standardize Approach for Funding Nursing Expansion**

- Given the rapid increases in nursing enrollment, we recommend that the Legislature provide UC and CSU with additional funding above the normal marginal cost to cover recognized higher costs of nursing students. However, we recommend that growth in nursing enrollment be treated as part of the overall enrollment growth provided in the budget, which already includes funding for marginal cost. (*Analysis*, page E-210.)

HEALTH

➤ **Short-Term Savings in Proposition 36 Could Result in Long-Term Costs**

- We review the administration's proposal for a net reduction of \$25 million for Proposition 36 programs, discuss why this reduction might eventually result in increased prison costs, and recommend redirecting funds in order to support Proposition 36 programs at their current level. (*Analysis*, page C-29)

➤ **Data Match Increases Veterans' Access to Benefits and Reduces State Costs**

- We estimate a shift of veterans from Medi-Cal to the federal Veterans Administration health system could save the state up to \$250 million annually, while providing those veterans with quality health care services. We recommend that California join 42 other states participating in a federal data matching process that would facilitate achieving these goals. (*Analysis*, page C-42.)

➤ **Department of Public Health Reorganization Cost Neutrality Uncertain**

- The budget plan implements Chapter 241, Statutes of 2006 (SB 162, Ortiz), that creates a new Department of Public Health and Department of Health Care Services from the existing Department of Health Services. We recommend the Legislature require the administration to provide additional information to ensure cost neutrality as required under Chapter 241. (*Analysis*, page C-63.)

➤ **Governor's Health Care Reform Proposal Has Both Merit and Risks**

- The Governor has announced a comprehensive health care reform proposal aimed at ensuring that all Californians have health care coverage. While not reflected in the budget plan, the proposal is an important starting point for discussions on health care expansion in California, although it contains a number of fiscal risks and uncertainties which could exceed \$3.2 billion. (*P&I*, "Part V.")

➤ **Promoting Health Information Technology in California**

- Health information technology (HIT) offers the potential to improve health care delivery and quality, but adoption of these tools by health care providers has been slow. Our review assesses the potential for health information tools such as electronic health records and provides an overview of health information development efforts in government and the private sector. We conclude that the state should take steps to promote widespread adoption of HIT, and we outline several strategies to achieve that goal. (*P&I*, "Part V.")

SOCIAL SERVICES

➤ **CalWORKs Sanction and Time Limit Proposals Not Necessary to Avoid Federal Penalties**

- In order to increase work participation and avoid federal penalties, the Governor proposes new time limits and sanctions on children whose parents cannot or will not comply with California Work Opportunity and Responsibility to Kids (CalWORKs) work participation requirements. However, under the

budget's own assumptions, California will meet federal participation requirements by federal fiscal year 2008. Thus, these policy changes are not needed to avoid federal penalties, and we recommend their rejection. (*Analysis*, pages C-124, C-128, and C-133.)

- As an alternative to the Governor's full-family sanction, we recommend an in-person engagement strategy for cases in sanction status. If upon being contacted by a caseworker, the family does not have good cause, cannot meet an exemption criteria, and is unwilling to participate, we recommend reducing the family's grant to one-half of its total. (*Analysis*, page C-132.)

➤ **Redirect SSI/SSP COLA Funds to CalWORKs**

- For 2007-08, the Governor proposes to provide the statutory January 2008 cost-of-living adjustment (COLA) for Supplemental Security Income/State Supplementary Program (SSI/SSP) recipients and suspend the July 2007 CalWORKs COLA for low-income families with children. Thus, the Governor's proposal increases grants for SSI/SSP recipients who are currently above the federal poverty guideline, while it suspends COLAs for CalWORKs families whose grants are currently below the guideline. In order to more effectively utilize General Fund resources to reduce poverty, we recommend redirecting \$124 million of the funds proposed for the SSI/SSP COLA to provide the CalWORKs COLA. (*Analysis*, page C-19.)

➤ **Enhancing In-Home Supportive Services (IHSS) Program Integrity**

- In-Home Supportive Services recipients are assigned hours of service by their social workers. There is no explicit prohibition, however, on reallocating hours across tasks or weeks. Thus, recipients may believe that the hours they receive are flexible and treat them as a block grant of hours. We make several recommendations that clarify IHSS program expectations and increase the likelihood that IHSS recipients will receive the care they need to avoid nursing home placement. (*Analysis*, page C-142.)

➤ **IHSS Wage Freeze**

- The Governor's budget proposes to freeze state participation in wages for IHSS providers. Under current law, the state participates in wages and benefits up to \$11.10 per hour, rising to \$12.10 per hour in 2007-08. If all counties increase their wages up to \$12.10, the state faces a General Fund exposure of \$350 million annually. The proposed wage freeze would result in savings of about \$14 million in 2007-08, and would eliminate this \$350 million exposure. We estimate the General Fund costs of several alternatives to the Governor's proposal. (*Analysis*, page C-139.)

➤ **Child Support Pass-Through Options**

- The Federal Deficit Reduction Act of 2005 increases federal participation in the amount of child support that states may pass through to welfare families. Although there is no requirement that states pass through a portion of collected child support to welfare families, California passes through the first \$50 of child support. We discuss the potential costs and benefits of increasing the amount of child support that is passed through to welfare families. (*Analysis*, page C-110.)

➤ **Child Welfare Performance Has Improved, But State Still Faces Federal Penalties**

- One year ago, the state failed to meet all seven federally required goals for outcome measures in the child welfare system. Current data suggests that the state now meets federal goals in four of seven outcome measures. Despite this improvement, failure on the remaining three outcomes will likely result in over \$20 million in federal financial penalties in 2007-08. (*Analysis*, page C-157.)

➤ **Plan Upgrades Licensing Automation, but Delays Internet Access to Compliance of Information**

- The Department of Social Services (DSS) oversees the licensing of about 86,000 facilities which care for vulnerable populations of children, adults, and the elderly. The Governor's budget includes a two-year plan to improve DSS's automated data system in order to more accurately track facility inspections and enforcement actions. The two-year plan, however, does not include the posting of licensing compliance information on the Internet, which has been a goal of the Legislature. (*Analysis*, page C-168.)

CRIMINAL JUSTICE

➤ **Governor's Prison Overcrowding Package More Balanced, But Too Big**

- The administration proposes \$9.6 billion (combined General Fund and lease-revenue bonds) as part of a 14-part package of proposals designed primarily to address overcrowding in state prisons and county jails. We find that the package has merit in that it provides a balance between adding new beds and reducing the inmate population. However, we estimate that it would result in a large surplus of state prison capacity and provide the wrong mix of beds. We recommend consideration of an alternative package that would address overcrowding, result in a smaller surplus of prison capacity, and reduce state costs relative to the Governor's proposal. (*Analysis*, page D-52.)

➤ **The California Prison Receivership: An Update**

- The federal court appointment last year of a Receiver to take over the state's prison medical care system is already resulting in a number of actions intended to improve inmate care as well as significant uncertainties regarding the state costs and savings likely to result from his actions. Given this situation, it will be important for the Legislature to provide oversight of these major changes in the prison medical system and carefully review and modify as appropriate budget requests submitted on behalf of the Receiver. (*Analysis*, page D-82.)

➤ **Enhancing Public Safety by Increasing Parolee Employment**

- A majority of state parolees are not regularly employed, thereby increasing the likelihood that they will commit crimes and return to prison. We identify several steps the Legislature can take to increase rates of parolee employment, including better targeting of funding to cost-effective programs, continuing federal funding for them, looking outside of California for successful approaches, requiring the department to track parolee employment rates, improving contracts for job referral programs, and improving case management by parole agents. (*Analysis*, page D-102.)

➤ **Juvenile Population Shift Warranted,
But Construction Funding Not Justified**

- The budget plan reflects administration proposals to (1) shift some offenders from the state to the local level and (2) enact a new state grant program to build county juvenile facilities. We find that the shift in offenders to the local level could mutually benefit the state, counties, and the offenders and their families. However, we recommend rejection of the \$400 million in bond financing to build as many as 5,000 local juvenile beds, given the current excess of about 4,000 such beds. (*Analysis*, page D-147.)

➤ **State Has Inadequately Maintained Its Investment in
Prison Infrastructure**

- State prison facilities represent an investment in today's dollars of as much as \$20 billion. Nevertheless, the state faces a growing backlog of special repair work that now exceeds \$200 million, due in part to problems in the way preventative and other maintenance responsibilities are managed and organized. We recommend a series of actions to protect the state's major investment in prison infrastructure. (*Analysis*, page D-119.)

➤ **Courthouse Bond Proposal Deserves Close Scrutiny**

- The Governor proposes to place a \$2 billion bond issue on the ballot for courthouse construction and to establish public-private partnerships to leverage additional resources for this purpose. We withhold recommendation on the bond issue pending further review of the proposal. We recommend rejection of the companion legislation for public-private partnerships because it provides a weak model for legislative control and oversight of these major projects. (*Analysis*, page D-17.)

➤ **An Update on the Implementation of Proposition 69**

- Our review of the Proposition 69 DNA Program finds that it is likely to require \$10 million to \$20 million annually from the General Fund if all incoming samples were to be processed on a timely basis. Although the Department of Justice has taken steps to reduce a backlog of samples, it faces difficulties in recruiting and retaining staff to handle its workload and must also deal with the expected increase in samples in 2009 that is likely to significantly increase the backlog. (*Analysis*, page D-26.)

TRANSPORTATION

➤ **Eliminate Arcane Spillover to Simplify Transportation Funding Structure**

- The “spillover” mechanism—a source of transit funding—is arcane and outdated with the passage of Proposition 42, which results in all state gasoline sales tax revenues being used for transportation. We recommend that the mechanism be eliminated effective 2008-09. This would simplify the transportation funding structure and increase the predictability and stability of the Public Transportation Account. (*Analysis*, page A-25.)

➤ **Governor’s Proposition 1B Proposals Circumvent Accountability**

- The budget proposes to appropriate in 2007-08 three years’ worth of Proposition 1B bond funds, even though the administration has not as yet identified the projects to be funded with these monies. In addition, the budget proposes to give the administration the authority to transfer these funds among programs. These proposals run counter to the bond measure’s intent that the Legislature appropriate specific amounts for various programs. The “power of the purse”—appropriation authority—is one of the Legislature’s most powerful tools to ensure accountability. We recommend rejecting the Governor’s proposals as they would circumvent accountability in how funds are used. (*Analysis*, page A-52.)

➤ **Slow Progress in Traffic Congestion Relief**

- Seven years into the Traffic Congestion Relief Program, only 26 of 141 projects have been completed. This is because delayed state funding and cost increases have impeded the delivery of projects. Looking forward, the availability of state funding and costs increases will continue to threaten project delivery. We recommend steps that the Legislature can take so that projects are completed, including setting project deadlines and reverting funds where projects are no longer viable. (*Analysis*, page A-63.)

➤ **Aging Highway System Requires More Maintenance and Rehabilitation**

- The state faces increasing costs to maintain and rehabilitate its highways as the system ages. While the budget proposes more funding for these activities, it does not address the long-term issue that maintenance and rehabilitation requirements are growing faster than the revenues which pay for them. As a consequence, there is an estimated \$2 billion annual shortfall in funding for highway maintenance and rehabilitation. We offer options for the Legislature's consideration in addressing this shortfall, including increasing and indexing the gasoline tax. (*Analysis*, page A-30.)

➤ **Time to Bite the Bullet for the Bullet Train**

- The Governor proposes to indefinitely postpone submitting a high-speed rail bond measure to the voters. The budget provides \$1.2 million to support the High-Speed Rail Authority, but provides no money for contract services to develop the rail system. This would essentially end the project unless another source of funding is provided. We recommend that the Legislature decide whether to continue the project or disband the authority. (*Analysis*, page A-77.)

➤ **Real ID Regulations and Funding a Big Question**

- It is virtually impossible for California—or any other state—to implement Real ID by the federal deadline of May 2008, especially in light of the delayed federal regulations. Given the lack of federal direction to date, the absence of any federal plan to fund the law's costly implementation, and growing opposition to the program in a number of other states, we recommend the Legislature and administration go slowly, and limit any state funding to planning activities. (*Analysis*, page A-88.)

RESOURCES

➤ **\$2.3 Billion of Bond Expenditures: State Should Proceed Carefully**

- The budget proposes over \$2.3 billion in bond funding for various resources programs, a majority coming from two resources bonds approved by voters in November 2006—Proposition 1E (\$4.1 billion for flood management) and Proposition 84 (\$5.4 billion for various water projects, natural resource protection, and park improvements). This reflects substantially higher bond expenditures than in the current year, particularly for flood management.
- We think that there are a number of actions that the Legislature can take to ensure that the new bonds are implemented effectively, efficiently, and consistent with legislative priorities. For example, we recommend that the Legislature set funding priorities and eligibility criteria to guide a number of new programs created by the bonds. The Legislature should also establish appropriate cost-sharing arrangements, particularly for flood management projects, and ensure similar bond programs are coordinated and administrative costs are reasonable. (*Analysis*, page B-17.)

➤ **Implementation of AB 32 Heats Up, but Leaves Legislature in the Cold**

- The budget proposes a \$36 million, multiagency effort to implement the Global Warming Solutions Act of 2006 (also known as “AB 32”) to reduce the state’s greenhouse gas emissions. In a number of areas, the proposal moves ahead of or is contrary to legislative direction. We therefore recommend eliminating funding for activities at the Secretary for Environmental Protection and the California Public Utilities Commission that are inconsistent with the act. We also recommend legislative language that would bar the implementation of “market-based mechanisms” until the Air Resources Board has comprehensively evaluated them and advised the Legislature of its findings. (*Analysis*, page B-50.)

➤ **Flood of New Flood Control Spending on the Horizon, But What Is Guiding It?**

- The budget proposes spending \$624 million from the Proposition 1E flood management bond in the budget year, but the Department of Water Resources is late in submitting a required expenditure plan for these funds. In addition, the department’s criteria for selection of bond-funded projects are unclear. If a systematic approach to project selection is not used, this could potentially result in unwise flood control investments that increase flood risk, rather than reduce it.

- We also find that there is not a process in place to provide an adequate level of independent oversight of the department's new flood-related capital outlay projects. We therefore recommend the Legislature withhold its approval on all flood-related capital outlay projects until the department addresses these shortcomings. (*Analysis*, page B-117.)

➤ **State Water Project Has Increasingly Important Role in Statewide Water Policy**

- The role of the State Water Project (SWP)—the state's main water conveyance system connecting Northern and Southern California—has changed significantly since voters approved a bond in 1960 to begin its construction. Increasingly, SWP is fiscally and programmatically related to a number of the state's water programs, such as the CALFED Bay-Delta Program, that receive their funding in the annual budget bill. However, SWP is "off budget," meaning that it is not subject to legislative appropriation in the budget bill. This off-budget status makes it difficult for the Legislature to comprehensively evaluate the state's water policy issues. Therefore, we recommend that SWP be brought on budget, in order to facilitate legislative oversight of these issues. (*Analysis*, page B-129.)

➤ **Surface Water Supply Projects Need Funding Partners**

- We recommend that the Legislature deny \$9.8 million of state bond funding proposed to continue feasibility studies for two surface storage projects, given the lack of identified federal and/or local funding partners necessary to allow the studies to practically move forward. (*Analysis*, page B-46.)

➤ **Improvements Needed in Water Board's Information Technology (IT) Activity**

- On numerous occasions, the Legislature has stressed the fundamental role that management of data—including data on permitting, enforcement, and water quality—plays in assisting the State Water Resources Control Board carry out its mission. There is room for improvement in the board's IT activity. For example, due to the constantly expanding scope of some IT projects, backlogs in the entry of data have occurred at the regional board level, resulting in less than complete water quality data being displayed on publicly accessible Web sites. We make a number of recommendations to improve the board's IT activity and to provide the necessary oversight of its projects. (*Analysis*, page B-139.)

➤ **Science Still Out on State's Regulation of Drinking Water Contaminants**

- The Office of Environmental Health Hazard Assessment (OEHHA) develops public health goals (PHGs) that serve as the scientific basis for the state's drinking water standards that are adopted and enforced by the Department of Public Health. We find that OEHHA has consistently lagged statutory timelines for developing PHGs and keeping them current. Absent up-to-date PHGs, the Department of Public Health lacks a scientific basis for regulating drinking water contaminants, such as perchlorate, more stringently than the floor set by the federal standards that otherwise govern. We recommend that OEHHA report on the resources it requires to complete its statutorily defined responsibilities in a timelier manner, and we provide a fee-based funding source for it to do so. (*Analysis*, page B-145.)

➤ **San Joaquin River Restoration Lawsuit Settlement: Responsible Parties Should Pay First**

- The budget proposes to use \$14 million in Proposition 84 bond funds to implement a recent court settlement providing for the restoration of the San Joaquin River. While the state is not a party to the lawsuit, the budget, nonetheless, proposes to use state funds to implement the settlement, before Congress has authorized the federal share of funds under the settlement. We recommend against appropriating any state funds for the restoration until the federal funding contribution is secured. (*Analysis*, page B-63.)

➤ **Wildland Firefighting Expenditures Continue to Rise Significantly**

- The fire protection budget of the California Department of Forestry and Fire Protection (mostly funded from the state General Fund) continues to rise significantly, and is proposed at \$1.2 billion for the budget year. While the primary mission of the department is to provide wildland fire protection, it also responds to medical emergencies and structure fires, which are not state responsibilities.
- We make a number of recommendations to control the rising costs, including clarifying state and local roles for providing emergency services, modifying the criteria by which land is designated a state responsibility for fire protection, and enacting a fee on private landowners to partially cover the state's costs in providing fire protection services that benefit them. (*Analysis*, page B-77.)

➤ **Budget Fails to Address State Parks Maintenance Requirements**

- Last year, the Legislature appropriated \$250 million from the General Fund to partially address an over \$900 million backlog in state parks deferred maintenance projects. The budget proposes to transfer \$160 million from this

appropriation back to the General Fund—the amount projected to be unspent at the end of the current fiscal year—while proposing no replacement funding sources. We recommend appropriating \$160 million in Proposition 84 bond funds for deferred maintenance projects to replace the General Fund monies proposed to be returned to the General Fund. We also recommend augmenting the department’s ongoing maintenance budget by \$15 million per year, funded from increased park fees, to slow the growth in the department’s deferred maintenance problem. (*Analysis*, page B-102.)

➤ **Telephone Ratepayer Relief on the Horizon**

- One of the Public Utilities Commission’s programs which provides subsidies to larger telephone corporations serving high cost areas has a projected fund balance of \$333.5 million. A statutorily required review by the commission of this program’s cost-effectiveness is long overdue. In light of the fund balance, we recommend that the commission phase out and eliminate the telephone surcharge that pays for this program. (*Analysis*, page B-153.)

GENERAL GOVERNMENT

➤ **Guaranteeing Teacher Benefit Not Advisable**

- The administration proposes to reduce contributions to the California State Teachers’ Retirement System’s purchasing power account—which protects retired teachers’ benefits from being eroded by inflation—by \$75 million on an ongoing basis. The reduction in contributions would be accompanied by a state guarantee of protection from inflation. There are risks to achieving the savings because the state could be obligated to make much higher contributions in the future if there is high inflation or poor investment returns. We recommend rejecting the proposal. (*Analysis*, page F-68.)

➤ **Cost-of-Living Increase for State Employees Appears Overbudgeted**

- The Governor’s budget includes \$549 million (\$155 million General Fund) to pay for 2007-08 general salary increases for state employees. For employees in 15 of the state’s 21 bargaining units, these raises are tied to a specific inflation rate for the 12 months ending in March 2007. The administration assumes that the inflation rate will be 3.3 percent. We believe the inflation rate (to be released in April) will be lower—an estimated 2.3 percent. This would save the state \$100 million (\$40 million General Fund). (*Analysis*, page F-119.)

➤ **Increasing Legislative Oversight of Employee Compensation**

- Recent agreements with unions, arbitration decisions, and administration actions have all undermined the Legislature’s ability to effectively oversee the compensation that is paid to state employees. We offer recommendations

that would (1) limit the authority of arbitrators to order large payments based on their interpretation of future labor agreements and (2) end the use of automatic pay raise formulas tied to actions by other governmental employers. (*P&I*, "Part V.")

➤ **Delete Midyear Reduction Authority for More Honest Budgeting**

- The administration assumes \$146 million in General Fund savings from proposed authority to reduce departmental budgets during the year. Savings from these types of proposals are rarely achieved. For instance, it is unclear how the Department of Corrections and Rehabilitation will absorb a proposed \$31 million reduction—given that the department has experienced budget shortfalls of more than \$100 million every year since 2000-01. We recommend that the Legislature delete the proposed authority. The administration should identify any specific proposed savings in departmental budgets during the spring budget process and how it expects these savings to be achieved. (*Analysis*, page F-126.)

➤ **Governor Proposes IT Changes**

- The Governor's budget proposes a \$1.3 billion project over the next decade to develop a new statewide financial IT system that would be used by all departments. Our analysis discusses the primary components of this project proposal, key issues the Legislature should consider in evaluating the project, and recommends additional oversight tools if the Legislature decides the project should go forward. (*Analysis*, page F-81.)
- The administration also proposes a number of changes to the state's IT governance structure. While components of the proposal have merit, we recommend several changes. Specifically, in order to maintain objectivity, we recommend not moving IT project oversight from the Department of Finance to the Chief Information Officer (CIO). In addition, to avoid creating another layer of review, we recommend rejecting a separate security office. Instead, the CIO's new responsibilities should include data security. (*Analysis*, page F-28.)

CAPITAL OUTLAY

➤ **Effectively Implementing the November 2006 Bond Package**

- The infusion of \$43 billion in bond funds authorized at the November 2006 election provides the state with a major opportunity to make infrastructure investments that will last for a generation or more. More than \$18 billion of the funds is allocated to 21 new programs. In designing the framework for these new programs, the Legislature should emphasize long-term benefits and statewide priorities. A program's goals and the criteria for selecting projects should be clearly defined. The Legislature can add additional oversight by

rejecting the use of continuous appropriations, limiting administrative costs, using special committees and joint hearings, and requiring and reviewing annual reports. (*Analysis*, page G-13.)

- Of the \$43 billion, the Governor proposes spending \$2.8 billion in 2006-07 and an additional \$8.7 billion in 2007-08. The Governor recently issued an executive order on increasing accountability and public information of the bonds. The Legislature will want to ensure that the audits and Web site called for in the order are strategically implemented to avoid duplicating existing accountability measures. (*Analysis*, page G-27.)
- In paying off these bonds, the state's debt burden will rise to a peak of 5.6 percent of annual revenues in 2010-11. (*Analysis*, page G-20.)

➤ **Governor Proposes Billions in Additional Borrowing**

- The Governor proposes \$29 billion in additional general obligation bonds to be put before the voters at the 2008 and 2010 elections. The Governor also proposes \$12 billion in lease-revenue bonds, primarily for corrections and local jails. If approved, this additional borrowing would raise the state's debt burden to a peak of 6.1 percent of annual revenues in 2014-15. (*Analysis*, page G-10.)

LOCAL GOVERNMENT

➤ **Improving the Mandate Process**

- The State Constitution requires the state to reimburse local governments for state mandates, but the process for determining the existence of mandates and providing payments for them is a major source of state-local friction. Building on the administration's reform proposal, we offer the Legislature a three-part plan that would greatly simplify and expedite the mandate determination process. (*P&I*, "Part V.")